Modification Report
RG0252 Proposal 10: Alignment of Defaulting User Threshold with Insolvency Act (1986) Threshold
Modification Reference Number 0307
Version 2.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

WWU raised Review Group 0252 "Review of Network Operator Credit Arrangements" in April 2009. This was convened to discuss the appropriateness of the existing credit management arrangements, taking into account the many credit related issues which had occurred since the publication of Ofgems "Best practice guidelines for gas and electricity network operator credit cover" (BPG) document.

Background

Currently UNC TPD V4.3.1 stipulates that a User Default occurs where a Shipper User's debt is in excess of £10,000 and accordingly the relevant Transporter is entitled to issue a Termination Notice to the Defaulting User, pursuant to TPD V4.3.3. In addition to each individual Transporter's potential exposure to £10,000 there is currently a mis-alignment between the UNC and the Insolvency Act (1986) where the prescribed debt limit is set to £750. Prior to Distribution Network sales, where there existed a single Transporter organisation, the £10,000 limit may have been appropriate, specific to these circumstances, however post Distribution Network Sales, where there exists five Transporter licence holders the potential exposure to total debt across all organisations is up to £50,000.

The intent of this Modification Proposal is to align UNC Section V 4.3.1 (a) with the Insolvency Act 1986 thereby having the effect of reducing the £10,000 threshold to £750 in relation to circumstances where a Shipper User can be defined as a Defaulting User. This also ensures the limit is appropriate going forward by linking it to the Insolvency Act 1986 rather than an arbitrary value.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

This Proposal is not classified as a User Pays Modification Proposal as it does not create or amend any User Pays services.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

Implementation of this UNC Modification Proposal would better facilitate Standard Special Condition A11.1 (a) by reducing the cost of operating the pipeline system by reducing the risk of exposure of the Transporter to bad debt without an offsetting income where a Shipper User has incurred a level of debt.

Standard Special Condition A11.1 (b): so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of

(i) the combined pipe-line system, and/ or

(ii) the pipe-line system of one or more other relevant gas transporters;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;

(ii) between relevant suppliers; and/or

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

Implementation of this UNC Modification Proposal would better facilitate Standard Special Condition A11.1 (d) (i) by reducing the risk of Transporters applying to the Authority for a Pass through of unrecovered debt to other Shipper Users and A11.1 (d) (iii) by reducing the likelihood for each Transporter of incurring bad debt.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security

standards… are satisfied as respects the availability of gas to their domestic customers;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

Implementation would not be expected to better facilitate this relevant objective.

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

There are no implications for operation of the System.

b) Development and capital cost and operating cost implications:

No such implications have been identified.

c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

No additional cost recovery is proposed.

d) Analysis of the consequences (if any) this proposal would have on price regulation:

Not applicable.

6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The contractual risk to each Transporter would be reduced following the implementation of this Modification Proposal as the amounts each Transporter could potentially be exposed to, prior to being able to issue a Termination Notice, would be reduced.

7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No implications have been identified.

8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

No implications have been identified.

Development and capital cost and operating cost implications

No implications have been identified.

Consequence for the level of contractual risk of Users

A Users contractual risk will be higher as the debt trigger level will be reduced.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No implications have been identified.

10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No consequences have been identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Alignment of the UNC Section V4.3.1 (a) and the Insolvency Act 1986
- This would reduce Transporters financial risk exposure by allowing an earlier issue of a Termination Notice (when compared with prevailing arrangements) where appropriate

Disadvantages

No disadvantages have been identified.

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

BGT	Supports

Contract Natural Gas	Not in Support
E.ON UK	Not in Support
First:utility	Not in Support
National Grid Distribution	Supports
National Grid NTS	Supports
Northern Gas Networks	Supports
RWE Npower	Qualified Support
Scotia Gas Networks	Supports
ScottishPower	Supports
SSE	Supports
Wales & West Utilities	Supports

In summary of the 12 representations received, 8 support implementation, 1 offered qualified support and 3 opposed implementation of the proposal.

Contract Natural Gas considers the Proposal is a disproportionate measure that could in practice create significant disruption to the operation of the industry that would far outweigh any improvement to the efficient and economic operation of the pipeline system. The threshold of £750 that is proposed is significantly smaller than the amounts billed, particularly for the larger shippers, so a small dispute could lead to the activities of a significant shipper being stopped, with consequential impacts on other industry participants.
Contract Natural Gas also consider that this proposal would not better secure effective competition between shippers. As the issuing of a termination notice would be at the transporter's discretion, there is a risk that any such provision would be selectively enforced, with smaller shippers being more likely to be the subject of a termination notice, as the impact from terminating a smaller shipper would be much less than for a larger shipper.

E.ON UK is concerned that by significantly reducing the threshold at which Users can be terminated from £10,000 to £750, there is a real risk of unnecessary termination actions being taken, affecting all Users. Whilst clearly any bad debt is unwanted, it does not seem prudent or proportionate for Transporters to be considering such extreme measures as termination over such small amounts. Measures to incentivise better performance by Users would be more appropriate for debts of this level. There is clearly a level at which the bad debt becomes untenable and a risk to other Users, which is, EON assume, where the current £10,000 figure comes from.

First Utility considers the proposed reduction of the threshold at which a Transporter can take steps to recover debt from a Shipper User by means of sanction or termination from £10,000 to £750 seems both severe and disproportionate. They accept the argument made by the proposer that, post Distribution Network Sales, the potential total debt across all five Transporters is £50,000 rather than the original £10,000. However, instituting a £750 threshold for each Transporter would institute a potential total debt across all five Transporters of £3,750 - £6,250 less than the original figure, which was borne, at the time, by a single Transporter.

National Grid Distribution considers adoption of the Insolvency Act trigger would appear to be a significant reduction compared to prevailing terms. This value refers to individual Transporters and therefore a User is able to effectively accrue up to £3,750 outstanding debt (subject to remaining less than £750 in debt per Transporter) before triggering the User Default terms. As the incorporation in Network Code of the existing £10,000 limit predates the sale by National Grid of a number of its Distribution Networks in 2005, it is clear that the existing terms effectively enabling £50,000 to be accrued before a User is considered in Default is an unintended consequence.

Northern Gas Networks supports the Proposal, which seeks to reduce the level of debt at which a User could be considered to Default to that aligned with the Insolvency Act (1986). This provides consistency with commercial practice and by aligning with the Insolvency Act (1986) the value will become flexible in the event of future change to the legislation.

Both ScottishPower and SSE notes that the Insolvency Act has a payment window of 21 days but under the Code the payment should be made within 15 days, this is therefore inconsistent with the Insolvency Act.

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

It is suggested that this Proposal be implemented on 1st October 2010 to coincide with the implementation of the other credit proposals being considered in this timeframe. Should this date not be achievable, then implementation could take place immediately following an Authority direction.

17 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel held on 19 August 2010, the eleven Panel Members present determined by PANEL MAJORITY to recommend implementation of the Proposal, with seven Members voting in favour.

The Panel Chair noted that twelve responses had been received, of which eight supported implementation, one offered qualified support and three opposed implementation of the Proposal. He suggested that clear and effective credit requirements within the UNC provide protection and reassurance for all parties, helping to prevent bad debt escalating to inappropriate levels. Requiring credit provision also provides an appropriate barrier to entry. Hence including appropriate credit arrangements within the UNC is consistent with facilitating effective competition between Shippers. Consequently reviewing and improving the arrangements where appropriate is also consistent with facilitating effective competition.

The Panel Chair summarised that Proposal 0307 seeks to align UNC Section V 4.3.1 (a) with the Insolvency Act 1986 thereby reducing the £10,000 threshold to £750 in relation to circumstances where a Shipper User can be defined as a Defaulting User. This limit would be linked to the Insolvency Act 1986 rather than being a fixed value. By allowing action to be taken at lower values, implementation would be expected to reduce bad debt and so facilitate effective competition. However, the ability to terminate Users for values as low as £750 could be regarded as disproportionate and inappropriate. It may also be seen as disadvantaging smaller Users, termination of whom may be more likely because of the limited market impact. Hence implementation may not facilitate effective competition.

The EDF Energy Panel member was concerned about the situation where a User exceeds the £750 threshold and a Transporter does not terminate them - how will Transporters administer the process to make it non-discriminatory, not disruptive and also manage risk effectively. The Wales & West Panel member advised that that the insolvency act is referenced as a fair approach for administration purposes without the need to reference an arbitrary value in the UNC. The GdF Suez Panel member expressed a view that £750 seemed minimal when set in the context of the values involved in the energy industry. The National Grid NTS Panel member advised that there could be Users who consistently operate just within the existing £10k limit, and this would impose costs and risks on Transporters and the industry.

The Shell Gas Direct Panel member asked what the process would be to terminate a User. The National Grid NTS Panel advised it is down the each individual case and there are no set criteria. The Consumer Focus Panel member asked if the insolvency act predates the UNC and, if so, why was the threshold originally set at £10k. The Northern Gas Networks Panel member advised that efforts to establish the origin of the £10k had not revealed why that level was chosen.

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

20 Text

For and on behalf of the Relevant Gas Transporters:

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